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Cowles, Walter Goodman

The New York standard compensation policy

[Hartford]

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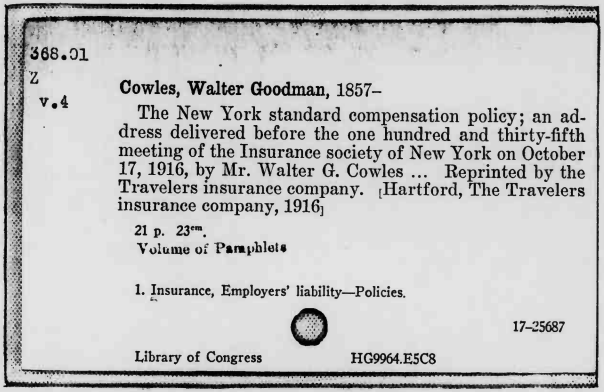

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The New York Standard Compensation Policy

AN ADDRESS

DELIVERED BEFORE THE ONE HUNDRED AND

THIRTY-FIFTH MEETING OF

The Insurance Society of New York

ON

October 17, 1916

BY

MR. WALTER G. COWLES, Vice-President

THE TRAVELERS INSURANCE COMPANY

Reprinted by The Travelers Insurance Company

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The New York Standard Compensation Policy Forms

There are in use at present three so-called New York standard forms. One form is supposed to be general and unlimited in its scope and covering power as well as in all other particulars and this, I presume, may be called the principal form. A limited form was also authorized, and a so-called chauffeurs' form which is unimportant and really unnecessary. As time is limited and hypercriticism is not intended, I shall disregard the chauffeurs' form, directing attention particularly to the more serious faults of the general form and incidentally to the variations in the limited form.

I wish to make it particularly clear to you that nothing which I may say upon the subject assigned to me is in any way intended as a criticism of the past, or of those who had connection with the preparation of these forms. The New York compensation law became effective at a time when scant provision had been made for suitable preparation. New York is a great industrial state and the difficulties attendant upon the introduction of a new and far-reaching relation affecting the employing interests were many and perplexing. Uniformity of action in as many directions as possible was clearly indicated and, while there was some difference of opinion, a great many insurance men favored drastic steps to obtain this uniformity and thereby reduce the resulting confusion. The Rating Board and policy forms grew out of a condition as it then existed which in the judgment of many made these provisions necessary. Some insurance managers have felt that the adoption of a state standard form, and particularly the form which was adopted, was not only unnecessary but involved grievous error, but those who held to that opinion yielded to the majority; and the uniform plans were perfected with necessary haste and the natural imperfections which result from haste. Our question is not respecting the past. Whatever errors or misconceptions were involved, it would be neither fair nor proper for me nor any one else to criticise them. Our question concerns the future. We have a little more time now and we can well afford to take accurate account of our situation that our future course may be better considered. It is to the future only and the changes which in my judgment should be made in policy procedure that my remarks are to be addressed.

I shall not at this time urge the obvious point that the state of New York has absolutely no legal right to require the companies to use standard policy forms. No policy form can be made compulsory except by an act of the legislature which includes the entire policy form; and no such act has been passed. There are a large

number of arguments which can be adduced to prove that there should be no differing standard policy forms for different states. If there is to be a standard form at all, it must be for the entire country because of intimate interstate relations and the expense and confusion attendant upon covering those operations under standard state forms.

Let us first consider the Declarations which constitute an important part of our insurance contracts.

Item 2 fixes the policy term as beginning at midnight on a certain day and expiring at midnight on a certain other day. The wisdom of a provision that a policy shall begin and end at midnight is in my judgment doubtful. It is not a crucial feature from an underwriting standpoint, but it is inconsistent in its practical application. For a great many years it has been the practice in at least many forms of term insurance that terms shall begin and end at twelve o'clock noon. As business enterprises are rather likely to begin in the morning, a noon effective hour is likely to result in dating a policy back to the previous day to the disadvantage of the policyholder. In compensation and liability business involving payroll audits there is another objection that the audit for the days at the beginning and at the end of the policy term must be divided if we would be accurate. On the whole there are several objections to twelve o'clock noon as the effective as well as the expiration hour. I have very serious doubt if these objections are removed by substituting twelve o'clock midnight. The great difficulty with twelve o'clock midnight as the effective hour is that it produces an inconsistency on the face of the contract. A policy written to become effective on this seventeenth day of October at twelve o'clock midnight is not as a matter of fact effective today at all. Twelve o'clock midnight is at the close of the day. In order to cover any operations undertaken during October 17th the policy must be dated October 16th. We are, therefore, in the inconsistent position of apparently granting insurance upon a given day when as a matter of fact we do not grant any insurance until the following day. This is particularly objectionable when applied to the writing of business to cover a compensation act which became effective on January 1st in any year. All that business must be written December 31st and strictly form a part of the previous year's business while it does not become effective during that year. The confusion resulting from this condition is well understood by those who have to do with the accounting which results. We are really obliged to treat our business upon a fictitious basis. After considering all these features and while recognizing that every objection cannot be removed by the choice of any particular hour, I feel strongly inclined to the opinion that not only in New York state but elsewhere, policy terms should begin on a given day at 12:01 A. M. Under this practice insurance is provided for the day which is named in the policy as the effective day. It is, however, true that we transfer our objection to the expiration

day, but I think that is less important. I, therefore, strongly commend for your consideration the plan that all policies shall become effective and expire at 12:01 A. M. on given dates.

There are a great many things to be said in criticism of item 3 of the Declarations and the tabulation which it includes. There is a slight difference of little real meaning between the general form and the limited form in the introductory statement. The general form reads, "Locations of all factories, shops, yards, buildings, premises or other work places of the Employer by town or city with street and number". The limited form reads, "Locations of all factories, shops, yards, buildings, premises or other work places of the Employer *to which this policy applies* by town or city with street and number *are as follows*". The added words are meaningless because they are capable of more than one construction. If the employer happens to be a corporation, what is it "to which this policy applies"? Is it the employer, or is it the work place? This expression is employed in an inartificial way to accomplish a result which it does not accomplish. It is supposed to limit operations to the work places, and yet the policy itself by definite provision extends the coverage beyond the work places. The limitation must be found elsewhere in the contract if found at all. We shall consider that point a little later.

The second column bears the heading, "Manual Premium Rate per $100 of Employees' Payroll". Why "manual" and why "payroll"? The manual premium rate is seldom used in these days of schedule rating. A form which calls for the manual rate and which provides for no other is improper and misleading. "Payroll" is not the proper word because the premium rate may apply to something which is not strictly payroll. Item 4 uses the expression: "entire remuneration of whatsoever kind". The word "remuneration" would be less misleading and more accurate.

In subdivision (a) of the tabulation we find "General Business Operations upon the Employer's Premises", etc. That is all right, —in fact, quite necessary for some lines. The use of this expression in practically all manufacturing lines is essential, but there are many other lines to which it does not apply. This is notably true of contractors' lines and it is also true in a large measure in public service lines and many other forms of coverage involving the maintenance and use of appliances on public highways and elsewhere beyond the premises of the employer. Hence, one suggestion at this point is that there shall be another form designed in this and other particulars to properly cover an entirely different line of risks requiring an entirely different method of underwriting. I shall speak of this as the "contracting form". There are other features in this schedule having reference to the same condition. Subdivisions (m) and (n) may be mentioned particularly. Subdivision (m) reads "Employees engaged in the repair, alteration and construction of buildings, structures or plants (except machinery)". This is inapplicable to contractors' risks and should not be maintained as an available classification in a contractors' policy for obvious

reasons. Subdivision (n) reading "Millwrights erecting, repairing and removing machinery not included in division (a) above" should be omitted from the contractors' form for the same reason. The items respecting drivers and chauffeurs are less objectionable although the work done by employees in these classes is usually more properly covered by the rate for the work than by any specific rates for drivers or chauffeurs. These items, however, can be left in the schedule and the words "included above" inserted where the rate for the governing classification is the rate for the drivers or chauffeurs engaged in the work.

These things are more than technical. They make for considerable confusion and considerable competitive manipulation. By the employment of this form for universal underwriting we subject ourselves to many possible misconceptions. Perhaps under the circumstances we might feel something like the man who came home early one morning in a somewhat maudlin condition and when his wife remonstrated with him not only because of his condition but because of the lateness of his arrival replied something in this fashion, "My dear, I was somewhat confused. I did not understand whether you told me I might have two drinks and return at eleven or eleven drinks and return at two". This man naturally chose the course which best suited his purposes.

The three divisions respecting drivers, chauffeurs and helpers could be rearranged to advantage if the chauffeurs' division followed the drivers' division and the helpers' division then became applicable to both. The helpers' division as expressed in the New York form is improper. It should not read "helpers and others *engaged in connection with* vehicles". That would cover all work done under many contracting classifications. It should read "helpers and others engaged upon vehicles", which under court precedents does not necessarily mean that the injury must be sustained upon a vehicle but that their duties are upon a vehicle rather than in connection with a vehicle.

In considering these suggestions it must be borne in mind that while in so-called manufacturing risks generally the principal operations are conducted at a fixed work place with incidental operations outside, the exact reverse of these conditions applies to contracting and also to many risks in public utility lines. The principal business operations are conducted at various places not upon premises of the employer, while the incidental operations are conducted upon such premises. In almost all these lines of operative procedure of any moment there is a business office or a work shop which is incident to the greater undertakings outside. In public utilities there are central stations, power houses and the like bearing a similar relation. Therefore, an entirely different division of operations should be provided for these two distinctly different lines. I would suggest that the two principal divisions of operations corresponding to (a) and (b) in the New York form be expressed for the purpose of our contracting form in substantially the following language,—(a) Business or contracting operations conducted, including all superintendence of such operations and all executive or clerical service at the place where such operations are conducted, excluding operations covered by (b) and (c) following". (b) Employees engaged at the shops, yards or other regular work places or premises of this employer as above located in connection with or preparation for the operations described in (a) foregoing."

Division (k) reading "Metal Stamping—give number of hand fed machines" is quite improper and in fact useless as stated. There is no occasion for this division at all in contracting lines, nor in manufacturing either if the stamping hazard is included in the governing classification. As a matter of fact it is included in a very large number of the manual classifications in which stamping is involved. There is no reason for inquiring respecting the number of machines. Inquiry usually brings no response, or if it is answered at all, it is answered at random by the agent or broker. It serves no purpose whether answered or unanswered and some might so far misunderstand the words as to think that the requirement was for the manufacturers' number on each machine. Blanks calling for facts are not always fully understood by those called upon to report upon them. A track foreman was supplied with blanks upon which to report animals killed by the trains. He desired to report the killing of a cow one day and when he came to the item in the blank reading "disposition of carcass" he scratched his head for a moment and finally wrote in the space provided "kind and gentle". This division to avoid all confusion and serve all the purposes for which it was intended should read "Metal Stamping, if separately rated".

Division (o) reads, "Blasting operations including all employees connected therewith". The last phrase means nothing. There is a manual rule which requires that there shall be maintained in all policies a minimum premium of $25.00 for this item. The requirement is unusual and it should be kept before policyholders and agents constantly because of its unusual nature. We have found it useful to insert a footnote in connection with a similar item stating that rule. Like metal stamping the blasting hazard is frequently included in the rate for the governing classification. It would be altogether better if this division should read "Blasting (if separately rated)" and then upon the theory that the enforcement of a special rule can best be obtained by constantly keeping that requirement prominent it will be fortunate if reference is made to a footnote reading substantially as follows, "If separate rate for blasting is required by manual, the payroll here stated shall include the whole compensation of all employees engaged in storing, handling or use of explosives and all employees engaged wholly or in part in work preparatory to blasting, minimum premium for this item $25.00." In matters of this kind it is well to follow the theories of the old colored mammy who had a couple of boys who were particularly well behaved at all times. A white lady for whom she worked inquired one day how she had raised

her boys to make them so well behaved, and mammy replied, "Ah raised dem boys wid a barrel stave, and Ah raised dem frequent."

Item 6 leaves much to be desired. We do not really mean to require our policyholders to declare that "No explosives will be made, stored or used on premises". Such a warranty would be strictly violated if kerosene, gasoline, paints and things of that character were kept on hand even in small quantities. Some years ago we modified this declaration to read, "No explosives intended for use as such will be made, stored or used on the premises". This comes a little nearer to expressing the real meaning, but still falls very far short of the mark. What we need respecting this hazard is a declaration which will be reasonable and at the same time exact. How can the companies obtain a reasonable knowledge of the existence of such a hazard which is not really suggested by the description of the business operations generally? If a business operation ordinarily involving no use of explosives and rated accordingly really involves the use or even the storage of a substantial explosive the hazard of such a risk becomes thereby very materially increased. In this explosive matter there is difficulty all along the line. We cannot define explosives in a manner satisfactory to ourselves nor to a policyholder. Where is the line drawn between rapid combustion and explosion. Perhaps it is currently understood that explosion involves detonation. Upon this theory it is not the explosive substance which actually explodes, but it is the container. If we ignite a quantity of powder lying open upon the ground we get rapid combustion. If we take the same quantity of powder and put it in a container which would furnish resistance we get an explosion. There are a large number of things which are currently known as explosives, but whether an actual explosion follows ignition depends more upon surrounding conditions than upon the substance itself. This declaration in many respects is an important and necessary one. Its correct expression is one of our problems yet to be solved.

The provisions of the New York policy form respecting minimum premium are erroneously expressed. In Condition A of the original policy form and in the reformed condition as exhibited by a more recent endorsement there is no reference to minimum premium which is an essential feature of the premium portion of the policy contract. There should be a reference to it. Condition A in whatever form it may otherwise be expressed should in my judgment universally end with substantially the following provision, "but in any event the Company shall retain the minimum premium stated in said Declarations." I regard the omission of this provision in the New York form as a substantial defect. In Condition E we find another error respecting the effect of short rate cancelation upon the minimum. The last clause of this condition reads "but such short rate premium shall not be less than the minimum premium stated in said Declarations." Obviously this provision should read, "but such short rate premium shall not

be less than the short rate portion of the minimum premium stated in said Declarations." I have understood that the New York Insurance Department has inquired of the companies recently on this point indicating that the retention of the entire minimum upon short rate cancelation would not be satisfactory to the Department. The companies are in the position of being compelled to write a policy in an improper way and adjust it in a proper way.

Some years ago a limited workmen's compensation act was passed by the New York legislature and signed by the Governor. It applied to eight so-called hazardous employments, and was generally known at the time as the Wainwright Law. It was afterwards declared unconstitutional as a whole. When this act became effective according to its terms, the insurance companies transacting this line of business, having developed a manual of rates for the purpose, proceeded to write the compensation obligation as expressed in the law. They carried this obligation in good faith, made a large number of claim payments and incurred further obligations for claim payments yet to come. After some months had expired the law was declared unconstitutional and some policyholders were unfair enough to claim that as the law was unconstitutional the insurance companies never carried any risk and should not be paid any premiums. A large majority of the policyholders were fair enough to admit that the insurance companies did carry the risk and did incur loss under that risk during the period which elapsed before the law was declared unconstitutional and these policyholders willingly paid the agreed premium. We have included in paragraph I of the insuring clause the following equitable and fair provision, "All premiums provided by this policy or by any endorsement hereon shall be fully earned whether such workmen's compensation law or any part thereof is now or shall hereafter be declared invalid or unconstitutional." It may be claimed that the danger of unconstitutionality of the New York law is very remote. What if it is? Is there any reason why the companies should be denied an opportunity to protect their premium earnings by an equitable and fair expression of the character which I have quoted? It is by no means sure that all features of the New York workmen's compensation law are constitutional, but whether sure or not the companies are entitled to the benefit of this provision. In the New York standard form an attempt is made in this direction by Condition F, but this attempt serves merely to make a bad matter worse. The policy would be much safer for the companies and much more equitable in ultimate adjustment under all conditions if Condition F had never been written. For convenience let us divide Condition F and consider the separate parts. The first part reads, "If the New York workmen's compensation law shall be declared invalid or unconstitutional in whole or in part by the judgment of the court of last resort, the premium rates provided by this policy or any endorsement hereon shall apply until the date of such judgment". Under this provision if a single section of the New York compensation law should be declared unconstitutional further premium charge upon

all policies would be suspended and subjected to adjustment upon the date of the final judgment of a court of last resort. This clause which is supposed to protect an actual right has really created a new disadvantage. There are several sections of the New York compensation law which in the judgment of many attorneys are probably unconstitutional. It is no wild dream to imagine that some court at some future time may declare some part of the law unconstitutional. Why should that event suspend or annul all compensation rates upon all compensation policies issued in the state of New York? Further than this, why should an employer who has adjusted his business affairs to the compensation obligation be denied an opportunity to continue to pay compensation to his workmen even if the law is declared unconstitutional? Is it fair to the companies to enforce the writing of business upon forms which squarely provide that when a part of the compensation law is declared unconstitutional all rates must be readjusted and employers cannot continue to pay compensation even if they desire to do so? I cannot believe that this provision was intentional. There is absolutely no reason why rates should be changed or the compensation obligation abrogated as a matter of policy contract upon a declaration of unconstitutionality. There is every reason why the employer himself should state whether or not he desires to take advantage of unconstitutionality and refuse longer to pay compensation to his employees. In actual practice we have found that compensation once established is preferred by many employers and that given a condition involving unconstitutionality they would rather continue the arrangement in anticipation of its early re-establishment than give it up. Why should this very desirable condition be made impossible? What element of public policy or public protection is served by it? The second part of this condition provides that "The Company shall immediately readjust the premium rates provided by this policy subject to the approval of the Superintendent of Insurance so as to equitably reflect the changed conditions?" What does that mean? If a compensation law actually becomes unconstitutional, then the old liability law is re-established and if the rates are to be changed, they are to be changed to liability rates. I have never known that the Superintendent of Insurance has any legal right to approve or disapprove specific liability rates. To establish such a provision as a matter of contract with a policyholder when the law confers no such power is unforgivable subterfuge. After giving this very important question careful consideration we have put into our policy forms a provision which reads as follows, "If at any time hereafter while this policy is in force any compensation law herein described shall be declared invalid or unconstitutional in whole or in part by the judgment of any court of last resort and this employer shall thereafter notify the Company in writing of his desire to eliminate from this policy all provision respecting the obligations contained in such compensation law, the Company upon receipt of such notice will adjust the premium rates in this policy to equitably reflect the changed obligation". This provision is in my judgment as

it should be. The severest critic, if he is fair, cannot conceive a reasonable objection to it unless it be that the last clause is rather general in form and leaves the fixing of rates with the insurance company. I can conceive of no real advantage because of this fact, but if any one should insist upon it I would say that it would be vastly better to provide in the policy that the employer might continue compensation if he wished and if he did not so wish that the policy might be canceled upon notice, the cancelation to be pro rata. I am rather confident that no real good reason can be assigned for denying to the company this opportunity to establish a continuing relation with a policyholder who may desire to maintain that relation. It is in favor of rather than against the true purpose of compensation.

There remain two very important points yet to be discussed. They are policy coverage and the executive payroll. I undertake the discussion of these points with some misgivings. I do not wish to impose upon you in the matter of time. There are a great many things which can be said, so many in fact that if I should undertake to say them I would find myself further from my clothes than Lady Godiva was when she first headed towards home during her famous ride. I will try to deal with them as briefly as possible.

The New York compensation law provides that an employer shall insure all of his operations if they come within the provisions of the act. If he fails to insure, penalties and added obligations are provided. With this general requirement as the basis the state authorities have reasoned that, since the law contemplates the coverage of all compensatable occupations, the insurance companies must be compelled to cover them whether they are disclosed in their policies or not. This proposition is not only unfair in the extreme but it seriously violates the fundamentals of insurance. All forms of insurance require definition of risks. The definition of risk under liability and compensation practice is difficult at best. Here we do not deal largely with named individuals or designated things. We deal with operations. A fundamental principle affecting the whole business of insurance is that a price known as the premium is proposed for a certain definitely described risk. The New York form compels us to provide insurance for an unknown risk not defined and for which no premium rate has been suggested or is permitted by the form. How long would fire insurance companies be able to submit to a proposition that if they insure one piece of property for an owner in the state of New York for a definite premium, that policy should be held to apply without added premium to any other piece of property which that owner happened to possess in any other part of the state and of which the insurance company had no knowledge? The risk is only disclosed by loss while the companies are called upon to carry an infinite number of risks without premium and without knowledge. Insurance simply cannot survive if we sacrifice reasonable definition of risk.

Many of the companies have already encountered surprises and all of the companies are today carrying risks of which they know nothing and for which they receive no premium compensation. There is no reason either in the realm of common sense or within the requirements of the New York law which justifies the state officials in requiring that any given employer who insures one enterprise with a certain insurance company shall be forced to automatically include all other enterprises. An employer has a right to go without insurance on some of his enterprises if he cares to take the risk and incur the penalty. I venture the assertion that there are a great many risks, running into the hundreds if not the thousands, in the state of New York which are not insured at all. There is every reason why insurance companies, as well as employers, should be permitted to define their risks and become liable for premiums and losses only upon the risks so defined. We are bound to find some distressing situations because of this requirement. We are plunging around in the dark. We are carrying a certain known number of defined risks for agreed premiums, and we are also carrying a certain unknown number of undefined risks without premium. An excursion through unfamiliar country in the dark is never quite safe. A bicyclist who was traveling a strange country road on a dark night discovered the dim outlines of a rather tall signpost at an intersection of roads. He had no light. He laboriously shinned up the pole until he reached the signboard. With great difficulty he struck a match and read thereon, "Wet paint".

By the provisions of these forms the insurance companies are constituted policemen but are denied their clubs and badges. The power to enforce the requirements of law that all operations covered by the law shall be protected by insurance in some form does not lie with the insurance companies.

In an effort to obtain expression for a very unreasonable requirement there has been produced a mixed result which would be distinctly humorous were it not so serious. The clauses chosen are at the same time too narrow in many respects and too broad in others. In paragraph VI we read "This Policy shall cover only employees of the Employer legally employed whose remuneration is included in said declarations". That expression taken by itself is entirely too narrow. It does not mean what it says. The remuneration expressed in the Declarations is only an estimate. There is no reason why a policy should be limited to an estimated remuneration when the actual remuneration may be different and perhaps include other employees not contemplated at the time the estimate was made. A better expression would be "This Policy shall apply to such injuries sustained by any person or persons legally employed by this Employer whose remuneration shall be included in the total actual remuneration for which provision is hereinafter made and upon which remuneration the premium for this policy is to be computed and adjusted." After having thus reduced the obligation beyond its intent the general form proceeds

with the following provision, "but nothing in this Policy shall be construed as excluding any employee who may become entitled to compensation under the provisions of the New York Workmen's Compensation Law and all amendments thereto, all of whom shall be expressly included". I have no hesitancy in stating that this requirement is made of the companies without the slightest warrant of law. May I remark again at this point that no method for obtaining premiums for this omnibus undertaking is provided in the form. The requirement cannot be justified by any necessity, by public policy or by any other reason except the convenience of those whose duty it is to see that the law is enforced. I would concede immediately that the desire of the Commission to see that compensation is secured to every employee is highly commendable, but it is not fair to attempt to obtain that result at the expense of the insurance companies. A limited policy form has been authorized by New York. By this authorization the right of the companies to undertake defined risks is admitted. No one has undertaken to enumerate the risks to which the limited form may be applied, nor is such enumeration possible. This limited form bears at its top a required legend reading "Standard Form Employers' Liability and Workmen's Compensation (limited as to employees covered) approved by the Insurance Department of the State of New York and acceptable as evidence of insurance by the State Workmen's Compensation Commission". The approval of this form concedes the right of the companies to undertake a limited risk. In an effort to limit the risk this form has become much too narrow and here we find the other extreme. Paragraph VI of this form reads "This Policy shall cover every employee of the Employer (wherever they may be) legally employed in the operation of the trade, business, profession or occupation set forth in the declarations and carried on at the locations therein specified and whose remuneration is included in the basis of premium for this Policy as set forth in Condition A." The unnecessary limitations in this form have already come to the attention of the New York State Commission. An amendment of this provision is under consideration. It is conceded by everybody that it is unfortunately expressed in the form. When an insurance company undertakes to cover a designated and defined enterprise, it can with propriety be required to cover work of all kinds incident to that enterprise and fairly connected with it. In that respect this form fails and in that respect an amendment is sought by the Commission. A better expression for all purposes of insurance would be "This agreement shall apply to such injuries so sustained by reason of the business operations described in said Declarations together with the operations incident thereto while conducted either at the work places therein described and defined or elsewhere in connection therewith". No reasonable critic can find substantial fault with the breadth of such an expression and I have understood that the Commission favors a somewhat similar expression as an amendment of the existing limited form.

Another fault of the same kind is found in Item 4 of the Declarations in both the general and limited forms. I refer to the following sentence, "If there shall be any change in or extension of the employers' business or if the employer shall make any structural additions, extraordinary repairs or alterations to his plant as above described, he shall pay therefor a premium based upon the Company's rates respectively applicable thereto." Under this provision if we insure a machine shop as such, and, during the term of the policy, that machine shop becomes an ammunition factory, that is a change in business. It is covered by the policy and a very uncertain provision is made to secure to the company a premium. The company is compelled to forego its right to obtain from its policyholder a disclosure of the changed condition. Is there any reason why the compensation insurance company with its very substantial unlimited hazard should have no notice of change in the policyholder's business, especially when that change involves decided increase of hazard? I surely can think of none. I surely can think of no hardship imposed upon a policyholder who is required to give notice of a change in his business. Reasoned to its fair conclusions insurance as a business cannot continue in the face of such requirements.

As respects the extension of a policyholder's business during the term of the policy the situation is somewhat different, depending of course upon the construction which would be put upon the expression. We understand extension to mean the growth or expansion of the same kind of business. If at the time of the issue of our policy a machine shop is occupying one building and during the term of the policy another is added, thereby enlarging both operation and space, there is no good reason why the policy should not apply to this kind of an extension, and if that is what the form means, it is unobjectionable.

The provision respecting construction, alteration and repairs, which may be made by a policyholder without notice to the insurance company is again unfair. Divisions (m) and (n) in the tabulation in item 3 adequately provide for disclosures respecting such operations. If the operations are contemplated when the policy is written, of course they should be disclosed. If they are undertaken unexpectedly after the policy is written, the insurance should not apply until they are disclosed by proper notice from the policyholder.

The time is surely coming when the companies cannot permit undisclosed risks of this nature to be imposed upon them. It is distinctly the preference of all companies to conduct their business under any reasonable requirement which the state authorities may propose. It is right and proper, however, that the state authorities should propose no other than reasonable conditions. A consideration of the unreasonableness and general unfairness of these requirements should be brought to the attention of the authorities and they should be urged to act with respect to the companies as the companies are attempting to act with respect to them,

and that is broadly and generously in an attempt to secure practical success in the operation of the insurance features of the workmen's compensation law. To accomplish this purpose there is no occasion for two forms, one to be unlimited and the other limited in its scope. There should be but one policy form as respects this feature, and that policy form should define a risk and accept all which goes with that risk. That is a reasonable solution of the situation. As I am personally convinced that the state authorities are not intending to act unreasonably, it seems to me not improbable that they will concede to the insurance companies the right to undertake a defined risk with its incidental operations and cover it to the exclusion of all other risks, and also the right to notice respecting any change in the operations conducted or in the place in which they are conducted which has any effect whatever upon the hazard. These are the fundamental rights and necessities of insurance and they should be recognized and will be in my judgment when the situation is brought to the attention of those who while trying to accomplish general compliance are failing because of unfamiliarity with its technique. The theory that an employer cannot insure a given complete operation without insuring everything else he undertakes cannot survive under any compensation act and the sooner it is abandoned the better it will be for all concerned, not only the insurance companies but the officials of the state and the employers who purchase insurance. Theoretically at least the premium cost of insurance can never be ascertained if in practice insurance is devised to cover undisclosed risks without premium consideration. No judgment upon the adequacy of rates is possible under such a practice. No rate is adequate for an unknown risk. Every time we incur a loss, as we frequently do because of these omnibus clauses, we rob our experience of its purity and we rob our enterprise of its sheet anchor.

The last feature to which I will direct your attention is a most important one. I refer to the treatment of that element of payroll ordinarily designated by insurance men as "executive payroll". The provisions in the New York policy forms are not only wholly bad in conception and expression, but they are seriously inexact. In condition A we find the following provision, "except that no premium charge shall be made upon any portion of the remuneration of any officer of a corporation in excess of $1,500 per annum." In item 3 subdivision (c) we find the words, "Executive officers of corporations (See Item 4)." A requirement was issued by the Department upon which a rule for the treatment of executive payroll was formulated and expressed by endorsement. In that endorsement the words "executive officers" are used. In item 4 to which reference is made in the preceding item we find the expression reads as follows,—"The entire remuneration of officers of corporations, but not in excess of fifteen hundred dollars per annum per officer, is included in the estimated remuneration above stated."

Here we have two distinctly different expressions which are given the same meaning by the context. One expression is "executive officers" and the other expression merely "officers". Either expression fails because of uncertainty. Honest opinions would vary infinitely as to who were executive officers or who were officers. The New York forms were prepared and promulgated to avoid competition in rates and resulting premiums, or, in short, for the purpose of obtaining uniform treatment of all risks of the same hazard. Yet within forms devised for that purpose we find opportunities for competitive procedure in a particularly destructive and unfortunate direction because that competitive procedure is based upon pure mathematical falsehood. I do not know that it makes any difference whether "executive officers" and "officers" mean the same thing or not. They practically serve the same purpose by furnishing legalized means of competition which practically ruins resulting experience. In the so-called experience upon which rate making proceeds, there are but two elements, payroll and loss. These elements are, or at least should be, mathematically exact because out of their relation one to the other we get that guidance which we all so sorely need in our rate making procedure. If any one should propose that elements of loss should be subject to change in amount for one reason or another, the objection to such procedure would I think be quite unanimous. Losses at least are exact and to change exact mathematical results for conjectured or manipulated results would strike every one as unwise and undesirable. If this is so clearly true of one element of our experience records, why is it not equally true of the other element? Is there any reason why payroll should be manipulated? When we begin the manipulation of payroll by substituting fictitious for exact amounts, we are merely substituting individual conception or competitive practice for mathematical accuracy. Sometime ago it was claimed by a few that all payroll should be manipulated to the end that a premium rate should not apply to payroll in excess of the statutory limit, by which I mean the limit to which the compensation scale is applicable, and that all payroll below the statutory minimum should be advanced to that minimum. This theory was promptly abandoned. The effect of such a procedure upon the resulting experience was too obviously bad to permit such a course to be considered. It has been claimed that many policyholders carry on their payrolls men in prominent positions who receive large salaries far in excess of the statutory limits, and that they ought not to pay the premium rate on those salaries in full. Our answer is that our premium rate applies to no man's salary but to the average of all, and that the average of all is well inside the statutory limit. That is a very important point to bear in mind. In the ordinary operating forces of a manufacturing plant, for example, we may find men, and perhaps women, who are earning all the way from a dollar or two a week up to $30.00 a week or perhaps more. Then we may find managers, superintendents, foremen and perhaps experts in certain lines who are

earning much more, some of them perhaps several thousand dollars a year. All these go in at their actual amounts to provide the average wage at that plant to which the premium rate applies. Unless wages are so treated there is no hope for the resulting experience. If the resulting rates are right or anywhere near right and we should proceed to manipulate our payroll, the rate would go up and the resulting premium would be the same. It is not the rate —which is merely a method of calculation—which is the crux of the matter. It is the resulting premium. At the inception of compensation in the state of New Jersey the companies began a practice of both computing and applying premium rates upon actual payroll. It is the only system which can survive. All companies agreed to this fundamental proposition recognizing that accuracy in experience could be obtained in no other way.

The next problem presented was with respect to such a treatment of actual payroll as would result in the same premium for the same hazard, whatever the organization of the employer might be. Here we find some difficulty. Employers may be individual, they may be partners or they may be corporate. Let us consider a purely imaginary case. There are two machine shops quite similar in the nature of product and each employing, we will say, one hundred men. One machine shop is owned and operated by a partnership having four members. The other is owned and operated by a corporation with a president, a vice-president, a secretary and a treasurer. Is there any difference in these two risks? Is there any reason why one should be charged more, or less, premium than the other?

We now proceed to compute the premium. We have assumed one hundred operatives in each plant. We now assume a convenient average wage of $500.00 per annum for each operative and the convenient insurance rate of 1%. We will also assume that the four named executive officers are each paid $1,500 a year or more. On the machine shop owned by the partnership we find we have a payroll of $50,000 a year, a rate of 1% and a resulting premium of $500.00. Turning to the machine shop owned by the corporation we find we have the same operative payroll of $50,000, but in addition we have four executive officers who must be included under the New York rule at $1,500 each or a total of $6,000, which makes the payroll of the corporate plant $56,000 and the resulting premium $560.00 If the executive payroll comes in at the clerical or other reduced rate there is a change in amount but no change in the principle involved. Is this result a proper one? Have we here proposed insurance for two risks of the same hazard at the same premium cost? The fact that this illustration is shaped to fit the argument does not destroy its usefulness. The exact conditions provided by the illustration may never be encountered in actual practice, but resulting inequalities of the same nature are found everywhere in our daily practice. I think I hear some one saying that these two risks which I have described are not similar. In the partnership risk the partners are individual employers and

cannot be liable to themselves for compensation, while in the corporation risk the four executive officers are employees and the corporation may be liable to them for compensation. The truth of that assertion is immediately admitted, but it does not affect the result.

We must now go into the realm of common knowledge. Here we learn that it is often and perhaps generally true that a concern owned and operated by several partners is a concern which has been built up from small beginnings by practical men who may themselves have worked at the bench or on the machines and who, when they became employers, continued in the active superintendence of their work and perhaps continued at work with their employees. If one of these partners happens to receive an injury, there would be no compensation payable to him, of course, but we must not lose sight of the fact that it is the office of a premium computation not only to take account of an injury but also of the cause of that injury. How many injuries are caused by the working partners in a concern of this kind? No one can answer that question, but every one will admit that it is more than theoretical. Going a step further in the field of common knowledge it is our observation that a very large majority of these partnerships employ no high priced men, the experienced partners doing that part of the work themselves, while the corporation is more likely to employ a superintendent or a general manager or some high paid expert whose compensation goes into the payroll at its full amount and serves to produce a true average of the wages at that plant. When we measure up one of these conditions against the other, fairness compels us to say that the corporate risk is certainly no greater, and may in theory at least be somewhat less than the partnership risk when both are judged in the light of common knowledge and under conditions which very generally result from these methods of doing business. The partnership situation as outlined is not universal and in cases in which it does not exist we would surely be more just, even to such occasional exceptional risk, and produce resulting premiums which are more nearly uniform, if we exclude from corporate payrolls certain selected and specifically named executive officers as a prototype of the individual or copartnership employers. The theory is a sound one.

The claim that the payroll of certain specifically named executive officers should not be included in the payroll upon which premium is computed is, however, supported by reasons beyond that which has just been stated. Executive payroll in many risks is rather uncertain in its character. The principal executives serve their corporation under varying arrangements. Some of them receive fixed salaries which may be low and a valuable participating interest in profits. Others may receive salaries and bonuses. Perhaps some receive increasing stock interests. Then, as we all know, we encounter conditions which make inquiries respecting the exact executive payroll rather embarrassing. Some corporations object to its disclosure. After many years of struggle with this

situation my company conceived the idea years ago that we should pick out certain named executive officers as the individual employer's prototypes. We should exclude their compensation entirely, but nevertheless we should cover them as employees for any obligation which the corporation might incur on account of their injuries. We have found the claim cost resulting from this element of payroll very inconsiderable. Losses have occasionally arisen, but it cannot be said that those losses stand without a premium representation. Out of the whole experience we have gathered a certain amount of loss, and we have also gathered a certain definite and accurate amount of payroll, excluding the executives named. We have applied our losses to that payroll and determined the rate, and this rate includes the value of the hazard of injury to the named executives. The premium is spread to an actual payroll. Beginning with New Jersey, rates were so computed. At the inception of compensation in Massachusetts where rates first became subject to Departmental observation we urged the acceptance of a similar rule. It was accepted and the uniform practice in Massachusetts so far as I know is to exclude the salaries of these named executives, but no others, from the payroll to which the rate is applied. Therefore, both the Massachusetts and the New Jersey experience was built up on that basis. The same thing was also true in Michigan. These three states and particularly Massachusetts, have furnished the basis for rate computations for New York and many other states. These rate computations proceed upon the actual payroll without manipulation of any kind, excluding these named executive officers who are covered nevertheless as employees and whose loss becomes a part of the loss of the risk and determines the rate to be applied to that risk in the manner indicated. The proposition is safe and it is both theoretically and mathematically exact. The resulting experience is untainted by manipulation because it consists of two mathematically exact quantities, payroll and loss. In New York we have the exact reverse. Rates which were devised to exclude executive officers are made to apply to their wages to a limited and fictitious extent. The laxity of the policy form permits the acceptance of the wages of pretty nearly any employee at $1,500 and at pretty nearly any premium rate. There are hundreds upon hundreds of cases treated by the companies and their payroll auditors in such a manner as their own conception may suggest or the necessities of competition may require. The result is inaccuracy. In short, it is pure fiction. Fiction rather than fact becomes an important element of our experience computation. How can rates ever be made right under such a desultory practice. Some companies have gone to great extremes in the employment of this competitive opportunity which the standard policy form of New York state permits. There is but one hope for this situation and that is that we should substitute absolute exactness and accuracy and proceed upon a basis which has in it no element, or at least little element, of individual conception or competitive opportunity. It is my personal belief,

supported by long study of the situation in the light of a considerable experience that this is best obtained by taking certain named officers of a corporation, excluding their salaries entirely and limiting the exclusion squarely and without variation to those officers. It will be claimed and is true that the duties of such officers are different in different corporations. In some corporations, for example, the secretary may also be the general manager or perhaps the superintendent. In another corporation one of the executive officers who is a graduate of the bench may continue at work among the regular operatives. How can this situation be reached? It seems to me it is fairly and completely reached by providing that if any of these named executive officers are connected with or participate in the operative procedure, the entire wages or other compensation of such an officer shall be included in the reported payroll and subjected to the premium rate. It has been claimed that this is discretionary and possibly competitive. I will frankly admit that it may be, to a very slight extent—so slight that we can always afford to leave it out as a provision of the policy and stand squarely on the unqualified statement that the wages of certain named executive officers are always to be excluded, whatever their duties may be.

There are only two or three states in the union where compensation laws now exist in which there is a requirement that executive payroll shall be treated in this fictitious fashion. All of those mistakes proceed from one source. I am sorry to say it, but it is true, that the New York requirement has been the occasion for similar requirements in states where less consideration has been given to the situation than in New York. That falsification of payroll has worked a great amount of harm, but it is not too late to stop it now. We are undoing that harm to a great extent now by abandoning this fallacy and proceeding with our business upon a basis of honest competitive equality. We must approach all these questions broadly and deal with them in a way likely to come as near as varying conditions will permit to a uniform non-competitive practice which produces the purest and most useful experience result. A very large majority of all the compensation experience now being produced throughout the country is produced upon the basis of exclusion of named executive officers. This should be made uniform and to that end I urge upon you gentlemen the careful consideration of this situation and the use of your influence in every possible direction to save the New York experience from further contamination by the abandonment of this procedure which has no support either in the field of reason or of necessity.

We are in the pioneer days of a tremendous enterprise. Generations to come will look back upon our work and draw from it the information needed for their guidance. The demands of the compensation plan and of any coming social insurance plan are that business shall proceed upon a uniform, non-competitive and well-considered basis of practice. By whatever means the social

insurance program of the distant future may be carried out or made effective, it is the obvious duty of those connected with that part of the plan which now exists, to produce a result which will be dependable. We are simply not doing it in the state of New York and our failure is due largely, if not entirely, to misconception of the situation up to the present time, but if continued it will surely be due to a deliberate failure to yield to the force of reason. We should each of us stand as champions for the rule of reason, believing that rule will eventually survive. When we have reached that point in the transaction of our business, many of its difficulties will disappear. Much of the confusion and misunderstanding between the companies themselves and between each of the companies and its customers will cease. We shall be doing business upon a solid basis of fact and the resulting experience will never mislead us or those who may succeed us.

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